

## Economics and politics of advertising: Evidence from the enlarging European Union

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### **Abstract:**

**Purpose** – The purpose of this paper is to investigate the impacts of economic and political factors on advertising industry in the enlarging EU.

**Design/methodology/approach** – The paper employed random effect time series cross-section (TSCS) models and cross sectional regressions to investigate the impacts of these factors on advertising industry in the enlarging EU.

**Findings** – It was found that marketers' advertising spending decisions in these economies are driven by consumers' income level and FDI inflow. Civil liberty related variables, on the other hand, were found to moderate the relationship between income and advertising spending.

**Practical implications** – This paper helps managers and practitioners understand the dynamics of advertising industry in the enlarging EU as well as in other parts of the world. Some fruitful avenues for future research include examination of consumers' perceptions of advertising in the rapidly changing Eastern European countries; use of qualitative methods to deepen the understanding of how consumers make sense of different forms of advertising; and in-depth analysis of advertising industries in selected economies.

**Originality/value** – The value of this paper is two-fold. First, it is one of the most comprehensive cross-country advertising studies examining the drivers of advertising industries in 28 European countries. Second, it employs TSCS models which allow for differences in behavior over cross sectional units as well as the differences in behavior over time for a given cross section and hence are likely to be consistent with the way the data were generated.

**Keyword(s):** Advertising; European Union; Civil law; Market economy; International investments

### **Article:**

#### **Introduction**

There is arguably an optimum amount of advertising that an economy can sustain (Bagwell and Ramey, 1994). A company's advertising spending in an economy is a function of a host of economic and geopolitical factors. Regional economic integrations bring significant transformations in economic and geopolitical factors (Ciuriak, 2003), which in turn, influence advertising.

The 1993 European Council meeting adopted a procedure under which enlargement was made conditional on compliance with three criteria: the existence of stable democratic institutions, a viable market economy, and an ability to assume the obligations of the European Union (Pavlov, 2003). The candidate countries thus are required to ensure the stability of institutions guaranteeing democracy, the rule of law, respect for human rights, and the promotion of free market economy. Newly joined and candidate countries have already experienced a by-product of fulfilling the minimum requirements in these domains, en route to their (imminent) entry into the EU (Zielonka, 2004). The effects of these changes on the advertising industry in Eastern European countries are already visible. In recent years, the growth rates in ad spending in these countries have been very high (Millan and Elliott, 2004). In 2004, new and candidate EU countries such as Romania, Lithuania, Hungary, Poland and Estonia were among Zenith Optimedia's top-20 countries by ad spending growth rates (Campaign, 2005).

In recent years, the advertising industry in Eastern Europe has captured the attention of the popular press. Nonetheless, there has been little academic research on the rapidly changing advertising landscape of the region. Koudelova and Whitelock (2001) found that of cross-country advertising studies only one (Synodinos *et al.*, 1989) focused on an Eastern European country–Yugoslavia. Not so clear is thus the identity of factors that will further enhance the advertising industry in these countries, and what the mechanism of enhancement will likely be. The exploration of these factors and associated mechanisms is the main topic of this paper.

Academicians, policymakers, and managers can learn valuable and important lessons from comparison of policies among countries and within and between international trading blocs (Bamosy *et al.*, 1997). The existing literature provides very little guidance on the matter. To fill the research gap, this paper attempts to investigate the impacts of economic and geopolitical factors on advertising spending (ad spending) in the enlarged EU countries.

The remainder of the paper is structured as follows: The next section discusses data used in this paper and their sources. Then, we draw upon literatures on economics and geopolitics of advertising to develop theoretical foundation and articulate some hypotheses about possible sources of drivers of the advertising industry. This is followed by a discussion of methodology, analysis and results. Finally, we provide implications and directions for future research.

Old members (OLD-15)	Added in May 2004	Candidate countries (CAND-3)
Austria	Cyprus (Greek part), the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia	Bulgaria and Romania (2007) Turkey at a later stage
Belgium		
Denmark		
Finland		
France		
Germany		
Greece		
Ireland		
Italy		
Luxembourg		
Netherlands		
Portugal		
Spain		
Swede		
UK		

**Note:** CAND-3 indicates the three candidate countries

**Table I.**  
Members of the  
enlarging EU

## Data and sources

Table I presents the EU's 15 old members (OLD); ten newly joined members (NEW) and three candidate (CAND) countries. We have denoted the latter two groups – new and candidate countries by NEW&C. We could not include Malta in any of the analyses because of data unavailability. The remaining 27 countries have been used in one or more of our analyses.

Most of the data related to ad spending and related indicators were obtained from Euromonitor publications. There are five major constraints related to the use of any international secondary data: accuracy, age, reliability, lumping and comparability (Kotabe and Helsen, 2001). Kotabe (2002) argues that Euromonitor, despite its reliance on various sources, addresses the first four constraints. We addressed the fifth constraint related to comparability of data by converting all local currencies into US dollars and converting into per capita figures. Euromonitor data have been used in several studies including Coulter *et al.* (2003), Dixon and Karboulonis (1999), Ein-Dor *et al.* (1997), Ganesh (1998), Ganesh *et al.* (1997).

Data on Civil Liberties index were obtained from the Freedom House's *Annual Surveys of Political Rights and Civil Liberties*. Civil Liberty index varies from one to seven – a higher number indicating a more severe

violation of civil liberties. Civil liberties are “...rights to free expression, to organize or demonstrate, as well as rights to a degree of autonomy such as is provided by freedom of religion, education, travel, and other personal rights” (Gastil, 1986, p. 7). Civil Liberty takes into account such factors as the existence of the Freedom of Expression and Belief; Association and Organizational Rights; Rule of Law and Human Rights; Personal Autonomy and Economic Rights; etc. We have denoted Freedom House's civil liberty index by LACKCL to indicate that a higher index represents more violation of freedom.

For the two-level freedom variable, free countries that are “closest to the ideals expressed in the (Freedom House's) civil liberties checklist” are given the level 2. Economies that have deficiencies in at least three aspects of civil liberties are given the level 1. Creation of the freedom variable thus entails reversing and collapsing categories in the LACKCL variable. Freedom House's political freedom data have been used in past studies (e.g. Diamond, 1992; Goldsmith, 1999).

Overall, Europe as a whole spends much less in advertising compared to the USA. According to *Euromonitor International*, total ad spending in the USA crossed US\$147 billion in 2003, which translates to per capita ad spending of US\$525. The 2003 per capita ad spending in each EU country and each candidate country is less than that in the USA (Table II). The data in Table II also indicate a significant heterogeneity of ad spending across the countries and media.

Ireland	298.51	56.8	19.3	187.64	2.84	29.57	2.27	31,747	6,422.66	1
Italy	150.25	82.4	7.43	51.61	1.25	5.89	1.60	24,845	280.90	1
Luxembourg	285.65	22.3	44.7	216.10	2.48			51,931		1
Netherlands	232.22	55.3	15.6	149.64	0.42	9.55	1.59	30,987	1,206.55	1
Portugal	91.34	48.3	6.04	23.08	0.75	12.51	0.65	11,868	91.91	1
Spain	153.66	62.6	14.2	60.81	1.22	13.32	1.52	20,307	627.26	1
Sweden	219.10	46.8	6.45	138.30	1.19	11.04	15.25	33,609	367.87	1
U.K.	283.80	89.0	11.7	155.42	5.01	17.27	5.23	30,869	244.86	1
OLD-15	212.61	68.9	11.3	112.62	2.11	14.30	3.45	27,364	480.034	
Cyprus	391.32	333.7	19.2	38.41				15,853	1,031.08	1
Czech Republic	119.77	58.76	5.89	47.18	0.21	6.88	0.86	8,456	253.19	2
Estonia	49.63	12.58	4.80	27.99		2.83	1.44	6,285	658.20	2
Hungary	163.12	102.88	7.22	38.78	0.52	13.72		6,327	244.11	2
Latvia	31.69	11.32	3.77	14.34		1.51	0.75	4,744	155.23	2
Lithuania	25.77	11.03	2.09	10.46		2.00	0.19	5,200	52.10	2
Poland	73.93	45.90	5.51	18.27	0.32	3.93		5,216	109.41	2
Slovakia	90.46	60.14	6.16	15.88	2.74	5.54		4,928	106.28	2
Slovenia	158.61	94.52	19.1	34.54		10.47		13,793	90.62	1
NEW-9	96.34	58.20	6.20	25.49	0.54	5.8	0.76	6,209.3		
Bulgaria	29.47	16.36		7.55		1.13		2,484	70.27	2
Romania	8.06	5.56	0.45	1.16		5.55		2,297	182.05	2
Turkey	14.81	7.35	0.77	5.41	0.12	0.89	0.04	2,767	8.07	4
CAND-3	14.46	7.6	0.69	4.64	0.12	1.94	0.04	2,642.6	165.54	
NEW&C-12	48.63	28.75	3.09	13.3	0.31	3.55	0.18	4,122	90.272	
EU-27	160.84	56.220	8.84	81.27	1.80	10.9	2.73	20,027	354.5415	

**Table II.**  
Per capita ad spending and related indicators in the enlarging EU (§, 2003)

**Notes:** NEW-9 indicates new countries added in May 2004 (except for Malta), CAND-3 indicates the three candidate countries (see Table I) and EU-27 includes the OLD-15; NEW-9 and CAND-3

## Theory and hypotheses

### Theoretical foundations

In this paper, we mainly focus on the impact of three supply side factors on marketers' ad spending: the level of economic development, foreign direct investment (FDI) inflows and orientation toward democracy.

**Economic development-advertising linkage.** Leff and Farley (1980, p. 65) have provided arguments for as well as against positive relationship between the advertising intensity in an economy and the level of development of the economy. Because of the relative newness of their offerings to the buying populace, marketers are required to inform consumers in developing countries to a greater extent compared to those in advanced economies. Moreover, developing markets are at a primitive stage but growing fast for a number of product categories. Similarly, in developing markets, a higher advertising intensity would help a firm strengthen its competitive position (Leff and Farley, 1980; Ramamurti, 2001). Moreover, consumers in developing countries are likely to have a more positive attitude towards advertising than those in developed countries. For instance, Chinese consumers are found to feel “largely neutral about advertising” (Chan and Cui, 2004) compared to consumers in the USA (Gaski and Etzel, 1986) and Australia (Chan *et al.*, 1990). These factors are thus likely to lead to a higher ad spending-sales ratio in developing countries than in developed countries. Moreover, advertising of products that have public health implications (e.g. tobacco) are banned in the advanced economies in some media (e.g. ban of TV advertising of cigarettes in the USA), many developing countries have no such restrictions (Gilmore and McKee, 2005; Lawton, 2002).

At the same time, there are a number of factors that work against increasing the advertising intensity in a developing country. Factors such as higher illiteracy rates among older groups that make most buying decisions; more costly advertising relative to its reach; and a higher proportion of rural population discourage marketers' ad spending in developing countries (Leff and Farley, 1980, p. 66).

The factors just discussed are ones that are likely to either encourage or discourage companies' ad spending as a whole in developing economies compared to developed economies. Additionally there is theoretical and empirical evidence suggesting that these two groups of economies differ on the proportions of ad spending that go to different media (e.g. print, TV and the internet). The use of different advertising media by consumers can be evaluated from a diffusion of innovation perspective (e.g. Antonelli, 1993; Dekimpe *et al.*, 2000; Gatignon and Robertson, 1985; Gruber and Verboven, 2001; Helsen *et al.*, 1993). According to this perspective, the gap between developed and developing countries is likely to be higher in the penetration of a newly introduced technology than in an old technology.

**FDI – advertising linkage.** Modern marketing practices in developing countries are spread by multinational corporations (MNCs) (Golding, 1977). To take one example, before 1989, the concept of branding was virtually unknown in the then Soviet Union. Starting the mid-1990s, a number of MNCs introduced their brands in Russia and developed new brands specifically for the country (Gilmore and McKee, 2005). What is more, some developing countries have taken special measures to attract foreign MNCs to develop the advertising sector. For instance, in March 2002, India allowed 100 percent foreign equity in the advertising industry (*EIU ViewsWire*, 2005).

FDI can be taken as a variable that reflects MNCs' marketing activities in an economy. FDI leads to a cross-border transfer of marketing skills and technologies enabling advertising (Manea and Pearce, 2001; Tahir and Larimo, 2004). In an analysis of 1,229 Japanese MNCs, Delios and Beamish (2005) found that firms' levels of FDI were positively related with the levels of advertising activities. In addition to these direct linkages, FDI also triggers modern marketing activities indirectly by facilitating political transformation, economic and industrial development, and by promoting democracy and market economy (Lankes and Venables, 1996; Resmini, 2000; Tahir and Larimo, 2004).

**Democracy-advertising linkage.** An economy's orientation toward democracy co-varies positively with the availability of media. Additionally, media literacy on the part of the populace is associated directly with democracy (Lewis and Jhally, 1998). Ewen (1996, p. 414) notes:

Media literacy... can democratize the realm of public expression and will magnify the possibility of meaningful public interactions.

On the other hand, in an attempt to discourage public interactions, authoritarian governments tend to control media availability. For instance, Stalin vetoed Trotsky's proposal to develop a modern telephone system in Russia commenting that:

It will unmake our work. No greater instrument for counterrevolution and conspiracy can be imagined (Boettinger, 1977, p. 206).

Marketing activities and advertising for that matter are tools for competition and promoters of economic democracy, the latter of which can be achieved through decentralization (Williamson, 1968). Advertising activities in a centrally planned economy are thus relegated by authoritarian governments to having limited roles in the economy. In their retrospective analysis of advertising industry of Bulgaria, Millan and Elliott (2004, p. 475) observe:

During the decades of central planning prior to 1989, the role of advertising in Bulgaria, as in most of the countries of Eastern Europe, was very limited ....

However, for many young Eastern European managers, marketing is currently a noble subject (Tixier, 2000). A country's progress toward democracy is thus expected to trigger marketing activities (Paramonov, 1998). For instance, the transition from central planning to market-oriented economies in Eastern and Central Europe and China led to the growth of modern marketing practices (Chan and Cui, 2004).

### *Hypotheses*

In this section, based on the theoretical foundation discussed above, we develop some hypotheses related to inter-country heterogeneity in ad spending.

*Inter-medium variances.* As discussed previously, a country's income level determines the adoption timing as well as diffusion speed of a new technology that can be used for advertising. That is, richer economies are likely to introduce a technology facilitating advertising earlier than poorer countries. The diffusion speed associated with a new technology enabling advertising is also expected to be higher in developed countries than in developing countries. The gap between developed and developing countries is thus likely to be bigger in the penetration rates of a newly introduced technology than that of an old technology. Since marketers' ad spending on a medium is expected to be positively related to the penetration rate of the medium, we can expect similar gaps in ad spending across media.

Consider, for instance, two European countries – Luxemburg and Bulgaria (Table II). We can posit a higher Luxemburg-Bulgaria gap in the diffusion of a newly introduced technology (e.g. internet) compared to an old technology (e.g. radio). We specifically consider four different forms of advertising: print, radio, TV and online. Among these, print advertising is older than radio advertising, which is older than TV advertising. Online advertising is the newest among all. We thus hypothesize that:

$$\begin{aligned} H1a. & \frac{\text{Per capita internet ad spending of the OLD EU} - 15}{\text{Per capita TV ad spending of the OLD EU} - 15} \\ & > \frac{\text{Per capita internet ad spending of the NEW \& C EU} - 12}{\text{Per capita TV ad spending of the NEW \& C EU} - 12} \\ H1b. & \frac{\text{Per capita TV ad spending of the OLD EU} - 15}{\text{Per capita radio ad spending of the OLD EU} - 15} \\ & > \frac{\text{Per capita TV ad spending of the NEW \& C EU} - 12}{\text{Per capita radio ad spending of the NEW \& C EU} - 12} \\ H1c. & \frac{\text{Per capita radio ad spending of the OLD EU} - 15}{\text{Per capita print ad spending of the OLD EU} - 15} \\ & > \frac{\text{Per capita radio ad spending of the NEW \& C EU} - 12}{\text{Per capita print ad spending of the NEW \& C EU} - 12} \end{aligned}$$

*Income.* Bagwell and Ramey (1994) argue that a firm that spends on advertising expects greater market share and profit, something that appears to be more likely in a country that has a higher income level and thus a higher purchasing power. Notwithstanding the contrarian arguments of (Leff and Farley, 1980), the level of economic development is likely to be associated with the adoption of modern marketing practices including advertising (Chan and Cui, 2004). Ad spending as a proportion of national income can be thus expected to be higher in developed countries than in developing countries. A 1998 study commissioned by the United Nations



Development Program (UNDP) indicated that only three developing countries – Colombia, South Korea and Venezuela, had advertising spending to GDP ratios than the USA (*Business Times*, 1998). At the aggregate level, we propose that *Ceteris paribus*[1] :

*H2.* The per capita ad spending in an economy is positively related to its per capita income (GNPPC).

**Freedom.** Bruce Barton, an Advertising Executive, Religious Writer, Copy Writer and United States Congressman, said that advertising was the “essence of democracy” (Carter, 1997). A country with stable democratic institutions is characterized by a higher penetration of communications media and freedom of the press and of speech. In such societies, the effort to control advertisings, even fraudulent ones, is viewed as an infringement on the freedom (Martinson, 2005). For instance, firms in the US tobacco industry are capitalizing on the “free speech” arguments to influence public policy[2].

While British, American, and Japanese cigarette manufacturers still enjoy advertising freedom in the developing countries of Asia and Eastern Europe (McKegney and Madden, 2001; Townsend, 2000), in general, authoritarian governments have distaste towards media and free speech. For instance, Singapore bans most privately owned satellite dishes and allows limited access for Cable News Network and pay-for-view TV channels (Clifford, 1993). Commenting on countries that had no internet connection until 1996, Maslen (1996) made the following observations:

In June 1996, just 20 countries remained with absolutely no e-mail or internet connection: Afghanistan, Bhutan, Burma, Burundi, Congo, Gabon, Guinea Bissau, Iraq, Liberia, Libya, Mauritania, North Korea, Oman, Rio Muni, Rwanda, Somalia, Syria, Western Sahara, Yemen, and Zaire... Of these countries, more than half are in Africa, in most cases only recently (50 years or less) free from colonial rule... Many of these countries are not wealthy, but there are surprising exceptions. Libya, Western Sahara, Oman and Gabon are relatively affluent, so their abstention from the internet cannot be explained in purely economic terms.

Based on above discussion, the following hypothesis is presented:

*H3.* The per capita ad spending in an economy is negatively related to the lack of freedom (or positively related to freedom).

At this point, it must be emphasized that three related but different variables are used to measure freedom or its lack thereof. As discussed in the last section, LACKCL measures the lack of civil liberties. FREEDOM variable is created by reversing and collapsing categories in the LACKCL variable. CLASS is a dummy variable created to control for membership in EU countries. It takes the value 1 for an old EU country and 2 for a new or a candidate country.

It must be noted that old EU economies are not strictly freer than new and candidate economies. For instance, according to Freedom House, Greece fares worse than Cyprus and Slovenia on civil liberty issues (Table II).

**FDI inflow.** As noted earlier, modern advertising practices across the world, especially in developing countries, are spread by MNCs (Golding, 1977). Advertising in developing countries are thus dominated by MNCs. For instance, the top ten international agency networks accounted for 48 per cent of the global advertising spending in 1993 (Wentz, 1993). In Asia, big internet advertisers have been mostly MNCs in technology sectors such as AT&T, Intel and Hewlett Packard. For instance, Intel was the biggest internet advertiser in India in 1999 (Pai, 2000) and was the first and one of the biggest online advertisers in China (Yue, 2000). MNCs' presence in an economy can be measured by the foreign direct investment (FDI) inflow. The above leads to the following:

*H4.* The per capita ad spending in an economy is positively related to the per capita FDI inflow.

**Interaction effects.** Advertising industry in Western European countries is relatively mature (Carter, 1997). In these economies, consumers are becoming increasingly cynical of advertising and are more difficult to reach via mass media (Cappo, 1992). For that reason, advertisers are, in places, shifting marketing dollars from media advertising to other forms of marketing (Cappo, 1992).

To respond to decreasing attractiveness of ads in their home countries and to capitalize on ever increasing demands in emerging markets, MNCs based in developed countries are rapidly expanding their businesses outside their home countries. In parallel with increased investments in the manufacturing sector, the advertising industry is also experiencing a stage of rapid development in most of the advanced developing countries such as those in Eastern Europe (Kaynak *et al.*, 1994). With increasing maturity, MNCs' focus on brands and products is expanding from regional to national to international to global (Industry Sector Analysis, 1998). A number of past studies have noted such trends. During the late 1980s to early 1990s, many French advertising agencies were responding to the maturing of their domestic markets when they increased their activities abroad (Seaman, 1991). Likewise, UK advertising companies have expanded their clientele worldwide, delving into new markets (Industry Sector Analysis, 1998).

The above leads to the following:

*H5a.* The marginal effect of increase in GNP per capita on ad spending per capita is higher in NEW&C EU-12 than in OLD EU-15.

*H5b.* The marginal effect of increase in FDI per capita on ad spending per capita is higher in NEW&C EU-12 than in OLD EU-15.

### Methodology, analysis, results and discussion

To test *H1a-H1c*, we employed *t*-test for the differences of means. A significant positive difference between the means of the ratios of per capita internet ad spending to per capita TV ad spending in the OLD-15 and NEW-12 is needed to support *H1a*. Similarly, significant positive differences between the means of similar ratios for TV to radio and radio to print ad spending are needed to support *H1b* and *H1c* respectively. The realized means and *t*-ratios are reported in Table III. For *H1a*, the difference of means failed to reach the significance level. For *H1b* and *H1c* the differences are significant but direction differed from hypothesized.

One possible explanation for Eastern European countries' relatively higher ratio of TV ad spending to radio ad spending (*H1b*) could be a legacy of the centrally-planned economies. In the central planning era, Eastern European governments had more positive attitude towards TV compared to radio. Comparing historical radio and TV controls in a number of Eastern European countries, Sparks and Reading (1994, p. 251) observe:

Unlike radio transmissions, there was never any attempt to jam or obstruct television signals...

	Original EU-15			New EU-12			<i>t</i> -value (difference of means)	<b>Table III.</b> Ratio of per capita ad spending in original EU-15 and New EU-12 (newly joined and candidate)
	Mean	Standard deviation	<i>N</i>	Mean	Standard deviation	<i>N</i>		
Online-TV ad ratio	0.09	0.129	12	0.04	0.046	5	0.69	
TV-radio ad ratio	5.59	2.83	15	8.86	4.67	11	− 2.2	
Radio-print ad ratio	0.139	0.081	15	0.29	0.147	11	− 3.4	

A similar finding regarding Eastern European countries' relatively higher emphasis on TV as compared to telephone can also be found in the results of Buchner (1988). He determined that penetration rates of telephone in comparison to television were higher in Eastern European countries than they were in their Western European counterparts. It very well may be, however, that this result merely reflects the basic relative economic benefits of the large width and size of the advertising audience in Eastern European economies. Similarly, print is a primary medium for advertising[3] (Table III) and market oriented economies such as those in the Western

Europe tend to have a much higher tendency to use this medium to market their products. Thus, print's relative advertising effect in Western Europe seems to be stronger than Eastern European countries' catching up in terms of the adoption of print media.

To test *H2* to *H5b*, we employed time series cross sectional (TSCS) models (for annual data for the period: 1999-2003) and cross sectional regressions for the 2003 data. Table IV presents the correlations among explanatory variables. Per capita total ad spending (TAD) is the dependent variable in both cases.

#### Time series cross sectional (TSCS) models and cross-sectional regressions

TSCS models are designed to overcome the limitations of usual linear models. When pooling data, it is highly likely that one or more assumptions of the usual linear model may be violated. Fomby *et al.* (1984, p. 337) point out several such possibilities. First, the error terms in a pooled model may be “heteroskedastic, auto-correlated and may exhibit contemporaneous correlation” which make generalized least square technique inappropriate. Second, the parameters of the data-generating process may differ from observation to observation. The reactions of different individuals may be different to changes in explanatory variables and the reactions may also change over time. TSCS models allow for differences in behavior over cross sectional units as well as the differences in behavior over time for a given cross section. In this way, such models are likely to be consistent with the way the data were generated (Fomby *et al.*, 1984). Problems related to such models include the selection of the most efficient estimation procedures and testing of hypotheses about the parameters.

We employed the following TSCS model:

$$TAD_{it} = \beta_{1it} + \sum_{k=2}^K \beta_{kit} X_{kit} + \varepsilon_{it} \quad (1)$$

where,  $TAD_{it}$  is the total ad spending and  $\beta_{1it}$  is the dummy variable for the  $i^{th}$  country for the  $t^{th}$  time period and  $\beta_{kit}$  ( $k \geq 2$ ) are the slopes.  $X_{kit}$  ( $k \geq 2$ ) is the value of the factor  $X_k$  for the  $i^{th}$  country in time  $t$ .

Several factors need to be taken into consideration in selecting the appropriate model. The first is the choice between fixed and random effect models. For the fixed effect (or dummy variable) model, the intercept term  $\beta_{1it}$  in (4) and (5) can be written as

$$\beta_{1it} = \alpha_i + \tau_t \quad (2)$$

where  $\alpha_i$  are the country “dummies” and  $\tau_t$  are the time “dummies”. The dummy variable model, however, eliminates a major portion of the variation among explained as well as explanatory variables if the between-country and between-time period variation is large (Maddala, 1971), a likely occurrence in advertising data. Additional problems include a loss in a substantial number of degrees of freedom and a lack of meaningful interpretation of the dummy variables (Maddala, 1971).

	GNPPC	LACKCL	FDI
TAD	0.80 *	-0.69 *	0.4 *
GNPPC		-0.72 *	0.37 **
LACKCL			-0.27

**Table IV.**  
Correlation matrix for the  
2003 data

**Notes:** GNPPC: GNP per capita; FDI: Foreign direct investment per capita; LACKCL: An index representing the lack of civil liberties. TAD: Per capita total advertising spending.  
\*Significant at 0.01 level, \*\* Significant at 0.10 level

These problems can be overcome by treating  $\alpha_i$  and  $\tau_t$  as random in which case only two parameters, the mean and the variance of the  $\alpha$ 's (and similarly for  $\tau$ 's), are estimated instead of  $N+T$  parameters in dummy variable models, where  $N$  is the number of cross-sections and  $T$  is the number of time periods. The procedure of treating  $\alpha_i$  and  $\tau_t$  as random can be rationalized by arguing that the dummy variables do in effect represent some ignorance – just like  $\varepsilon_{it}$ . Maddala (1971) argues that this type of ignorance, or “specific ignorance”, can be treated in the same manner as  $\varepsilon_{it}$ . Then the residual can be written as:

$$U_{it} = \alpha_i + \tau_t + \varepsilon_{it} \quad (3)$$



The Parks (1967) method, a random effect TSCS model, accounts for heteroskedasticity, auto-regression as well as contemporaneous correlation and hence appears to be the most appropriate model to study the multi-country ad spending. We thus estimated the Parks TSCS model by taking total ad spending as the dependent variable.

To test for the possible moderating effect of freedom, we also employed cross sectional regression analysis for the year 2003 (Table VI). The TSCS results in Table V indicate that *H2 H3* and *H4* have been supported in most of the cases. It is important to note that the metrically defined LACKCL variable in Table V measures the lack of civil liberties whereas the two-level FREEDOM variable, useful in capturing moderating effects, in Table VI measures the existence of civil liberties. The results in Tables V and VI indicate that the both class and freedom variables moderate the effect of income on ad spending. The significant positive interaction effect between GNPPC and CLASS (Table V) indicates that the marginal effect of income on advertising is significantly higher in NEW&C countries than in OLD countries. In the same vein, a significant negative interaction effect between GNPPC and FREEDOM (Table VI) indicates that the marginal effect of income on advertising is significantly higher in economies that currently have deficiencies some aspects of civil liberties than in economies that are closest to the ideals of freedom. The hypothesis concerning the moderating effect of freedom related variables (*H5b*) was not supported in the relationship between FDI per capita and total ad spending (Tables V and VI).

	DV = TAD		DV = TAD		DV = TAD		DV = TAD		DV = TAD		DV = TAD	
Intercept	-13.53	(-9.51)*	-18.2	(-5.8)*	55.88	(14.1)*	19.01	(1.3)	-26.09	(-0.9)	-18.3	(-7.5)*
GNPPC	0.002	(2.5)**	0.001	(0.9)	0.005	(51.9)*	0.007	(16.9)*	0.009	(18.4)*	0.001	(1.1)
LACKCL					-8.37	(-14.35)*	-3.33	(-0.7)				
FDI	0.008	(0.23)	0.004	(2.5)**			0.003	(1.7)***	0.003	(2.2)**		
CLASS									17.57	(1.1)		
GNPPC*CLASS	0.007	(13.61)*	0.008	(12.9)*							0.008	(14.11)*
FDI*CLASS	-0.001	(-0.29)									0.003	(3.23)*
N	25		25		27		25		25		25	
R <sup>2</sup>	0.991		0.999		0.994		0.95		0.97		0.999	

**Table V.**  
TSCS regression results (1999-2003) (Park's method)

**Notes:** GNPPC: GNP per capita; FDI: Foreign direct investment per capita; LACKCL: An index representing the lack of civil liberties; CLASS: A dummy variable to control for membership in EU countries. It takes the value 1 for an old EU country and 2 for a new or a candidate country.  
\*Significant at 0.01 level, \*\* Significant at 0.05 level, \*\*\* Significant at 0.10 level

	DV = TAD		DV = TAD		DV = TAD		DV = TAD	
Intercept	-13.5	(-1.8)***	-127.0	(-1.5)	-114.7	(-1.3)	-126.2	(-1.5)
GNPPC	0.02	(3.8)*	0.02	(3.2)*	0.02	(2.9)*	0.02	(3.3)*
FDI			0.01	(1.1)	-0.135	(-0.8)	-99.2	(-2.1)***
GNPPC*FREEDOM	-104.2	(-2.6)**	-96.9	(-2.0)***	-121.7	(-2.1)**		
FDI*FREEDOM					92.9	(0.8)	7.7	(1.1)
N	27		25		25		25	
F	29.8*		17.4*		13.0*		17.5*	
R <sup>2</sup>	0.71		0.71		0.72		0.71	
Adj. R <sup>2</sup>	0.69		0.67		0.66		0.67	

**Notes:** The numbers in the parentheses represent *t*-values.

\*Significant at 0.01 level, \*\*Significant at 0.05 level, \*\*\*Significant at 0.10 level.

GNPPC: GNP per capita; FDI: Foreign direct investment per capita; LACKCL: An index representing the lack of civil liberties; FREEDOM: Free countries that are "closest to the ideals expressed in the [Freedom House's] civil liberties checklist" are given the level 2. Economies that have deficiencies in at least three aspects of civil liberties are given the level 1; CLASS: A dummy variable to control for membership in EU countries. It takes the value 1 for an old EU country and 2 for a new or a candidate country

**Table VI.**  
Cross-sectional regression for 2003

## Implications and future research

An important contribution of this paper is to explore the drivers of ad spending in the enlarging EU. We found that ad spending in an economy is driven by the income level and FDI inflow. Analysts expect that EU membership will trigger stronger economic growth in new and candidate counties (EIU ViewsWire, 2003). There has already been an increase in FDI in new and candidate countries and EU membership is likely to further enhance investors' confidence and positive perceptions of these countries (EIU ViewsWire, 2004). The results of this paper imply that FDI growth will drive ad spending of Eastern European countries. Likewise, we also found a reasonably robust effect of freedom on ad spending. Although the enlargement has already boosted democracy in Eastern European countries, most of them haven't yet achieved democratic maturity (Zielonka, 2004). An implication of the findings of our analysis is that moves towards greater democracy in the newly joined and candidate countries may trigger further growth of the advertising industry.

The moderating effects of freedom related variables are particularly robust. The TSCS analyses indicated that the marginal effect of income on advertising is higher in new and candidate countries than in old members. Similarly, cross sectional analysis for 2003 data indicated that although income has a positive effect on advertising, the marginal effect of income on ad spending decreases as economies become freer.

Nonetheless, there are many factors not empirically accounted for in this paper that may influence the extent to which advertising – just one component of the promotional mix – is enhanced in a country's economy. One such factor concerns the nature of the target audience that is addressed by companies in the country. For instance, some experts argue that Central and Eastern Europeans trust less to advertising and other marketing messages from large organizations and tend to rely more on word-of-mouth recommendations (*DSN Retailing Today*, 2004). In this situation, personal selling involving ethnic employees may play more important roles. Similarly, when companies in a country place emphasis on industrial markets (as opposed to consumer markets), then one would expect a lower level of utilization of advertising (Leff and Farley, 1980). Similarly, when companies emphasize export markets (as opposed to domestic markets), then there will likely be a correspondingly greater emphasis on the use of personal selling in the promotional mix.

An important area of future research is examining the transferability of this research in other settings. To investigate the external validity of the models presented in this paper, further research is needed to test the impacts of variables listed above on ad spending of other regions of the world. The main effects of some variables and their interaction effects that failed to reach the level of significance for European economies may reach the level for a set of more heterogeneous economies (say, Asia). Similarly, the results could be different for a bigger set of economies.

This paper focused on the supply side of advertising in the enlarging EU. In this regard, another fruitful avenue for future research is to understand the demand side of this industry. Additional research is needed to examine how consumers in the rapidly changing Eastern European countries perceive advertising and how they are different from their Western European counterparts.

Whereas the quantitative models employed in this paper placed emphasis on insuring “tightness of control”, future research can pursue “richness in reality” (Mason, 1988) of the European advertising industry by using qualitative methods such as interpretive consumer research. Qualitative methods provide the basis for elaborations, interpretations and new ideas (Morse, 1992) and will further deepen the understanding of how consumers make sense of different forms of advertising.

Finally, additional research is also needed for in-depth analysis of advertising industries in selected economies, especially those in Eastern Europe. Especially, we recommend analyses of longitudinal patterns of the development of the advertising industry of an economy by using historical methods (Smith and Lux, 1993) or in a number of economies by using comparative historical analysis (Mahoney, 2004). In Hobsbawm's (1997, p. 42) terms, whereas econometric analyses employed in this paper focused on “particular strands from the seamless web of interaction”, historical analyses focus on the “web”. The end result of a historical analysis is the formation of a paradigm (Fischer, 1970; Smith and Lux, 1993) that explains drivers and inhibitors of advertising industry(ies) of one or selected economies.

#### Notes:

1. All the hypotheses are stated on a *Ceteris paribus* – other things being equal – basis. The phrase “*Ceteris paribus*” is implicit at the beginning of each hypothesis statement, and has not been explicitly stated (to avoid repetitiveness).
2. See “Tobacco Promotion and Freedom of Speech” available at: <http://www.treatycheck.org/Speech.htm>
3. For instance, the first US daily newspaper was established in 1784 primarily as a medium for advertising (Troy, 1999).

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